(25)

No. 96-1578

In The
Supreme Court of the United States
October Term, 1996

HON. THOMAS R. PHILLIPS, et al.,
Petitioners,

vs.

WASHINGTON LEGAL FOUNDATION, et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals For The Fifth Circuit

BRIEF OF DEFENDERS OF PROPERTY RIGHTS* AMERICAN ASSOCIATION FOR SMALL PROPERTY OWNERSHIP AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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BRIEF *AMICI CURIAE* OF

APARTMENT ASSOCIATION OF SOUTHEASTERN WISCONSIN, INC.
BOSTON PROPERTY EQUITY RIGHTS, INC.
CASSANDRA CHRONES MOORE
NATIONAL ASSOCIATION OF REVERSIONARY PROPERTY OWNERS
NEW HAMPSHIRE PROPERTY OWNERS' ASSOCIATION
OHIO REAL ESTATE INVESTORS ASSOCIATION
CLIFFORD F. THIES, PH.D
WESTERN PENNSYLVANIA REAL ESTATE INVESTORS ASSOCIATION

QUESTION PRESENTED FOR REVIEW

Is interest earned on client trust funds held in IOLTA accounts a property interest of the client, cognizable under the Fifth Amendment to the United States Constitution?

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CONSTITUTIONS AND STATUTES

Pursuant to Rule 37.3 of the Rules of this Court, *amici curiae* submit this brief in support of Respondents.[1] Both parties have consented to the filing of this brief.

IDENTITY AND INTEREST OF *AMICUS CURIAE*

Defenders of Property Rights is the only national legal defense foundation devoted exclusively to protecting private property rights. Defenders was founded as a non-profit, public interest firm in 1991. Its mission is to protect vigorously those rights considered essential by the Framers of the Constitution, and to promote a better understanding of the relationship between private property rights and individual rights and liberty. Defenders of Property Rights engages in litigation across the country on behalf of its members to prevent government incursion into protections guaranteed by the Bill of Rights. Defenders devotes a significant portion of its resources to litigation and has participated in *Lucas v. South Carolina Coastal Council, Dolan v. City of Tigard, Babbitt v. Sweet Home Chapter Communities for a Great Oregon, Bennett v. Spear, Suitum v.*

[1]No counsel for either party authored this brief *amici curiae*, either in whole or in part. Furthermore, no persons other than *amici curiae* (their members or counsel) contributed financially to the preparation of this brief.

Tahoe Regional Planning Agency and *Boerne v. Flores* when they were before this Court.

American Association for Small Property Ownership (Front Royal, VA), **Apartment Association of Southeastern Wisconsin, Inc.** (Milwaukie, WI), **New Hampshire Property Owners' Association** (Nashua, NH), **Ohio Real Estate Investors Association** (Cincinnati, OH), **Western Pennsylvania Real Estate Investors Association** (Pittsburgh, PA), **and Boston Property Equity Rights, Inc.** (Boston, MA) represent the interests of landlords property owners and real estate investors. Their collective goal is to restore common sense and equity to federal, state and local regulations, tax and liability and other laws that unconstitutionally impinge on the right of landlords, property owners and real estate investors to build wealth and success by the beneficial and productive use of property.

National Association of Reversionary Property Owners (Issaquah, WA) is nonprofit foundation whose major goal is to assist property owners in maintaining all ownership interests in land and to avoid the uncompensated confiscation of private property rights.

Cassandra Chrones Moore (Palo Alto, CA) is principal of CCM Associates. A property owner, consultant, realtor and public policy specialist, Ms. Moore is an adjunct scholar at the Competitive Enterprise Institute and the Cato Institute in

Washington, D.C. Her book, "Haunted Housing: How Toxic Scare Stories are Spooking the Public Out of House and Home," was published by Cato. She is a member of the Board of Directors of the American Association for Small Property Ownership which publishes "The Small Property Owner."

Clifford F. Thies, Ph.D (Winchester, VA) is the Durell Professor of Money, Banking and Finance at Shenandoah University. Formerly, he was named the Black & Decker Research Professor at the University of Baltimore, and in 1992, was a Bradley Resident Scholar at the University of Baltimore. The author and editor of four books and dozens of articles in scholarly journals and popular magazines, Dr. Thies is a member of the Board of Directors of the American Association for Small Property Ownership.

STATEMENT OF THE CASE

This case involves the taking by the state of Texas of interest earned on client fees paid to attorneys. Because attorneys often hold money for their clients, such as retainer fees or closing costs for a transaction, in escrow, the amount of money earned as interest in any given year is enormous. For example, the Texas IOLTA program alone has generated as much as $10 million per year in recent years. Pet. App. at 5a.

Until 1980, federal law prohibited banks from paying interest on demand accounts. As a result, these client escrow accounts formerly amounted to interest-free loans to the banks because the banks could keep any income generated by the accounts.

In 1980, new banking regulations allowed "negotiable order of withdrawal" (NOW) accounts, which operate as interest-bearing checking accounts. Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C.A. § 1832 (West, 1989). These accounts created a vehicle for attorneys to pool client funds into an interest-bearing trust account, as long as none of the funds belonged to a for-profit corporation.

As a result of the availability of interest-bearing demand accounts, forty-nine states and the District of Columbia adopted Interest On Lawyers Trust Accounts (IOLTA) programs, which clustered individual client funds of nominal amounts into larger accounts where the accruing interest goes to the states, rather than the clients or the depository banks. The aggregate interest was then collected by the states and dispensed to groups deemed "public interests" by the states.

SUMMARY OF ARGUMENT

In 1980, this Court held that state governments violate the Just Compensation Clause of the Fifth Amendment when they fail to pay accrued interest on private funds held by state courts in interpleader accounts. *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980). The Court, in holding that interest generated from privately owned funds is itself private property, indicated that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.* at 164. The Court then went on to hold that "a State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit in court." *Id.*

Webb's Fabulous Pharmacies is squarely on point with the instant case. In IOLTA accounts, private financial institutions hold and invest the funds of private individuals in return for a payment of interest. IOLTA accounts are only different from other types of interest-bearing accounts because state governments are appropriating the interest payments that properly belong to either the client or the financial institution. State governments, therefore, under the holding of *Webb's Fabulous Pharmacies*, are "taking"

private property without just compensation in violation of the Fifth Amendment.

Other decisions of this Court, including *Board of Regents v. Roth*, 408 U.S. 564 (1972), do not affect this analysis. In *Roth*, a government employee brought a challenge pursuant to the Free Speech Clause of the First Amendment and the Due Process Clause of the Fourteenth Amendment of the failure of the State of Wisconsin to renew his one-year employment contract. *Id.* at 566-68. This Court held that the employee had no protected property at stake because he could not have a "reasonable expectation" in continued employment by the state after the expiration of his one-year contract. *Id.* at 578.

Nothing in this Court's holding in *Roth* affects the issue of whether a client has property rights in interest generated from his IOLTA trust funds. Interest, unlike government benefits, is a tangible commodity that becomes the property of the owner of the principal, based on long-standing decisions of this Court and numerous state courts. Whether or not the owner of funds in a depository account has a "reasonable expectation" that his account will generate interest, any interest that actually accrues will still attach as a property right incident to his ownership of the underlying principal.

In short, IOLTA interest is private property that state governments may not simply take for their own use without violating the Fifth Amendment, regardless of the purpose for which the money is taken.

ARGUMENT

I. INTEREST EARNED ON CLIENT TRUST FUND ACCOUNTS CONSTITUTES PRIVATE PROPERTY UNDER CLEARLY ESTABLISHED LAW.

In their briefs before this Court, Petitioners and *amici curiae* supporting Petitioners attempt, at great length, to demonstrate that the interest generated by clients funds in IOLTA accounts is a form of public property "created" by the government. Br. of United States at 9. As the court below suggested, Petitioners apparently believe that:

> The IOLTA program represents a successful, modern-day attempt at alchemy. . . .modern society generally scoffs at this attempt to create "something from nothing." The defendants in this case denounce such skepticism, declaring that they have unlocked the magic that eluded the alchemists. The alchemists failed because the necessary ingredients for their magic did not exist in historical times: the combination of attorney's

client funds and anomalies in modern banking regulations.

Pet App. at 7a. These arguments, however, simply fail to support the claim that IOLTA interest should be treated as any anything other than the private property of the owners of the underlying principal funds.

A. Interest On IOLTA Funds Is No Different Than Any Other Type Of Interest Generated From Private Funds.

It is undisputed that IOLTA programs generate a tremendous amount of interest from client trust funds.[2] Petitioners, however, attempt to show that IOLTA interest is somehow different than normal interest and, as such, is not the property of the owner of the underlying principal. In fact, Petitioners cannot make such a showing because IOLTA interest is created in exactly the same way as any other form of interest.

In the broadest terms, "interest is the rental price of money." *Wilshire Holding Corp. v. C.I.R.*, 262 F.2d 51, 53 (9th Cir. 1958). Other courts have defined interest in terms of

[2] Petitioners concede that IOLTA programs nationwide raise approximately $100 million per year. Pet. Br. at 3.

compensation: "Interest is compensation paid for the use of money." *Western Plains Service Corp. v. Ponderosa Develop. Corp.*, 769 F.2d 654, 657 (10th Cir. 1985) *see also Miller v. Robertson*, 266 U.S. 243, 257 (1924)("One who has had the use of money owing to another justly may be required to pay interest from the time the payment should have been made."). The definition of interest, therefore, emphasizes the concept of remuneration to the owner of money in return for temporarily giving up the custody and use of the money. Essentially, a depository institution takes possession of another's money to be invested in return for a "rental" payment to the owner of the money.

Despite the assertions from Petitioners that IOLTA interest is somehow "created" by the government, IOLTA interest is generated in exactly the same way as normal interest. In other words, private financial institutions invest money owned by private individuals in return for a payment of interest. The difference with IOLTA accounts in simply in the end result: state governments step in and take the "rental value" of the money rather than the owner of the money or his assigns. But in no sense can governments claim that they "create" this money—they neither provide the principal funds nor take the investment risks necessary to generate IOLTA interest money. Therefore, the government must, of

necessity, be "taking" IOLTA interest from someone, either the client or the bank holding the client's principal funds.

B. Background Principles of State Law And Prior Decisions Of This Court Demonstrate Conclusively That Ownership Of Interest Follows Ownership Of The Underlying Principal.

Petitioners advance an additional theory as to why IOLTA interest belongs to state governments: that there is no absolute legal rule that ownership of interest follows principal. This argument, however, appears to give short shrift to previous decisions of this Court and to long-standing background principles of state law that hold exactly the opposite.

The court below relied upon this Court's opinion in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) in holding that ownership of IOLTA interest follows ownership of the underlying principal. In *Webb's Fabulous Pharmacies*, the plaintiff entered into an agreement to purchase the assets of a corporation that was heavily in debt. *Id.* at 156. To protect its interests, the plaintiff filed a complaint of interpleader in state court naming as defendants both the corporation and its creditors. *Id.* at 156-57. Under state law, the plaintiff was required to deposit the amount of the agreed purchase price into an interpleader account in the

court's registry. *Id.* at 157. After satisfying the claims of various creditors and withdrawing court fees, the clerk then returned the remainder of the interpleader account, but failed to pay the interest that the account had earned while in the possession of the court. *Id.* at 158. Plaintiff then filed a separate lawsuit against the state court clerk to recoup the interest generated on the interpleader fund.

This Court held that the withholding by the state court of payment of the interest on the interpleader fund was a "taking" of private property in violation of the Fifth Amendment. *Id.* at 165. In so holding, the Court noted that:

> Seminole County has not merely 'adjust[ed] the benefits and burdens of economic life to promote the common good'. . . . Rather the exaction is a forced contribution to general governmental revenues, and it is not reasonably related to the costs of using the courts.

Id. at 163(citations omitted).

The applicability of this Court's opinion in *Webb's Fabulous Pharmacies* to the present case could not be clearer. Clients whose funds are placed into IOLTA accounts are put in the position of making a "forced contribution" to state governments of any interest earned on their funds while they are held in the attorney's trust account.

Indeed, the legal analysis applied by this Court in *Webb's Fabulous Pharmacies* is equally applicable to the present case. The actions of the government in *Webb's Fabulous Pharmacies* were characterized by this Court as analogous to the physical appropriation of private property found in *United States v. Causby*. *Webb's Fabulous Pharmacies*, 449 U.S. at 164 (citing *United States v. Causby*, 328 U.S. 256 (1946)). In *Causby*, the federal government was held to have appropriated the airspace above private property for the flight pattern of military aircraft. *Causby*, 328 U.S. at 262. The Court, as a result, has applied to the issue of property rights in interest payments the reasoning from the line of cases concerned with physical invasions of private property.

This is an apt analogy in the present case, for, as indicated above, the government has, by legislative or judicial fiat, inserted itself as the "third party beneficiary" of the contract between the attorney, his client, and the depository bank holding the client's trust funds. *See Peoples Westchester Sav. Bank v. FDIC*, 961 F.2d 327, 331 (2d Cir. 1992)(comparing government's position in New York IOLA program to that of third party beneficiary). The government is, to put it plainly, confiscating money that, in fairness and conformity with legal precedent, should belong to either the client that provides the principal or the financial institution

that takes the risk of investing the principal to create the interest.

Faced with such unfavorable precedent from this Court, it is understandable that Petitioners argue that the reasoning in *Webb's Fabulous Pharmacies* may only be applied to the specific factual situation of that case. But this assertion by Petitioners is simply untrue. This Court has cited *Webb's Fabulous Pharmacies* as authority on numerous occasions in cases far more factually distinct than the present case.[3]

Even if this Court, however, were to hold that the reasoning of *Webb's Fabulous Pharmacies* is relevant only to its own facts, the general principle that ownership of interest accrues to whoever has ownership of the underlying principal funds has deep roots in this country's legal history.

This Court has long supported the proposition that interest follows principal in opinions dating all the way back to the early days of the Republic. *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 318 (1809)("interest goes with the principal, as

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[3] *See, e.g., Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1031 (1992)(challenging denial of building permit for dwelling on beachfront); *Preseault v. I.C.C.*, 494 U.S. 1, 20 (1990)(O'Connor, J., concurring)(Rails To Trails Act challenged on Fifth Amendment grounds); and *United States v. Sperry Co.*, 493 U.S. 52, 62 (1990)(challenging government deduction of fees from settlement of private claims against Iranian government).

the fruit with the tree."). Indeed, prior decisions of numerous state courts also support this basic rule of American jurisprudence.[4]

Petitioners, apparently realizing the lack of a legal or factual distinction between IOLTA interest and other types of interest, attempt to obfuscate this reality and focus the inquiry of this Court on the "expectations" of the clients whose money is being steered into IOLTA accounts. Petitioners' argument can be summarized as follows: A person who does not have a 'reasonable expectation' of receiving a return on the investment of their funds cannot claim a property right to any return that is, in fact, generated. This argument cannot be supported by prior decisions of this Court.

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[4] *See, e.g., City of Seattle v. King County*, 762 P.2d 1152, 1155 (Wash. App. 1988)("The judgment in the instant case is supported by the common law principle that interest on public funds follows the ownership of those funds"); *Thompson v. Gasparro*, 257 N.W.2d 355, 356 (Minn. 1977)("It is a general rule that interest is an integral part of the debt and a claim for it must stand or fall with the principal debt"); *Liquidation of Canal Bank & Trust Co.*, 30 So. 2d 841, 852 (La. 1947)(". . . interest is a mere incident to the principal debt"); *In re Beckman*, 14 A.2d 581, 583 (Pa. Super. 1940)("The rule is that the principal of a claim cannot be placed on a different footing from the interest accruing thereon"); *Des Moines Mut. Hail & Cyclone Ins. Ass'n. v. Steen*, 175 N.W. 195 (N.D. 1919)("Now it is manifest that the accruing interest follows the principal . . .").

Petitioners base this argument on their interpretation of this Court's opinion in *Board of Regents v. Roth*, 408 U.S. 564 (1972). In *Roth*, the Court held:

> [t]o have a property interest *in a benefit*, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.

Id. at 577 (emphasis added). The plaintiff in *Roth* brought suit regarding the non-renewal of his employment contract by the state of Wisconsin. *Id.* at 568. This Court held that the plaintiff had no property interest in a contract renewal, since he had no reasonable expectation that it would be renewed. *Id.* at 578.

Roth, however, is inapposite to the present case. The "property" at issue in *Roth* was characterized as a government benefit, and the language of the Court's opinion explicitly limits the "reasonable expectation" requirement to this intangible and ephemeral form of "property." In the present case, the application of this standard would be ridiculous because the IOLTA interest exists as a tangible commodity, regardless of the expectations of the owner of the principal funds. In such a case, to hinge property

ownership on the existence of an appropriate level of "expectation" makes no sense.

Indeed, the existence of a property right without a reasonable expectation thereof is hardly unique to this case. Numerous instances can be shown where property owners can claim a right to property that they had no 'reasonable expectation' of receiving. One example is the purchaser of a lottery ticket. Given the extremely high odds against winning the grand prize in a lottery, the holder of a lottery ticket could hardly have a 'reasonable expectation' that they will become the grand prize winner. Nevertheless, the ticket holder who does ultimately win the grand prize has an undoubted property interest in the lottery proceeds.

Finally, in the context of normal private individual deposit accounts, a depositor might well open an account consisting of such a small amount of money that they do not expect to receive interest. But if a single penny of interest is earned on their funds, that penny does not magically belong to someone else, merely because the account holder did not expect his account to earn that penny in interest.

Quite simply, the law is clear that the owner of deposited funds has a property right to interest generated from that money, no matter what the mindset of the owner may be. There is no legally cognizable basis for state

governments to assert that a client has no property rights to interest generated from his trust funds.

II. GOVERNMENTS MAY NOT CIRCUMVENT THEIR CONSTITUTIONAL OBLIGATIONS BY ATTEMPTING TO "REDEFINE" PRIVATE PROPERTY INTO PUBLIC PROPERTY, NO MATTER HOW MERITORIOUS THEIR OBJECTIVE MAY BE.

Lacking any sound legal foundation for their assertion that clients do not have property rights in interest generated off of their IOLTA funds, Petitioners ultimately fall back on the argument that the ends justify the means: "By challenging IOLTA, Respondents attack the programs that provide many of America's elderly, its homeless, its sick, and its poor access to our justice system." Pet. Br. at 36.

In the American scheme of constitutional law, however, the ends do not justify the means when individual rights are undermined. As this Court said in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922): "We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Id.* at 416.

Moreover, this Court should not be misled by Petitioners' attempts to minimize the impact on clients of the

government appropriation of IOLTA interest. This court has previously indicated that even *de minimus* invasions of private property are to be treated as a violation of the Fifth Amendment. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435-36 (1982).

IOLTA programs are nothing less than an attempt to convert private property into public property under the cover of banking regulations. Whatever the purpose IOLTA programs are intended to serve, this conversion is a blatant attempt to circumvent the limitations of the Fifth Amendment. The continued existence of IOLTA programs represents a threat to the very concept of private property in this country, as it gives a signal to governments that they may appropriate private property through the simple process of "redefining" it as public property.

CONCLUSION

For all of the foregoing reasons, *amici curiae* urge this Court to uphold the decision below.

Respectfully submitted,

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